No. 93-313

Supreme Court, U.S.
FILED
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In The

Supreme Court of the United States

October Term, 1993

BDO SEIDMAN, BRACEWELL & PATTERSON, J.C. TEMPLETON, JOE H. FOY, HARRY V. CARLSON, ROBERT TED ENLOE, III, W.A. GRIFFIN, THOMAS L. KISTER, LEONARD LEON, EDWARD T. COTHAM, AND WILLIAM M. TEMPLETON,

Petitioners,

v.

GAYLON D. SIMMONS, GLORIA ANNETTE TURNER SIMMONS, GREENWICH INSURANCE COMPANY, AND THE UNITED STATES OF AMERICA,

Respondents.

On Petition For Writ Of Certiorari To The United States Court Of Appeals For The Fifth Circuit

BRIEF IN OPPOSITION

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STATEMENT OF THE CASE

Petitioners' Statement of the Case, while generally adequate, fails to include two key facts relevant to the Court's decision to deny or grant the petition. *First*, the district court dismissed Respondents' claims under Section 10(b) of the Securities Exchange Act of 1934 (the "1934 Act"), 15 U.S.C. § 78j(b), *without prejudice*. *See* Appendix at A2. The judgment of the district court thus lacked res judicata effect, as the district court specifically recognized. *See* Appendix at A13. *Second*, Petitioners did not appeal the district court's decision to dismiss Respondents' claim without prejudice.

REASONS FOR DENYING THE WRIT

1. The Decision of the Fifth Circuit is Correct.

Section 27A of the 1934 Act is presumptively constitutional. *Usery v. Turner Elkhorn Mining Co.*, 428 U.S. 1, 16 (1976). The United States Court of Appeals for the Fifth Circuit has tested the presumption in the case of Section 27A and, after detailed analysis, has concluded that Section 27A is consistent with the limitations on legislative and judicial powers set forth in Articles I and III of the Constitution. Seven other Circuit Courts of Appeals have also concluded that Section 27A is constitutional.[1] In the

[1] *Cooke v. Manufactured Homes, Inc.*, No. 93-1005, 1993 U.S. App. LEXIS 17167 (4th Cir. July 9, 1993); *Cooperativa de Ahorro y Credito Aguada v. Kidder, Peabody & Co.*, 993 F.2d 269 (1st Cir. 1993); *Berning v. A. G. Edwards & Sons, Inc.*, 990 F.2d 272 (7th Cir. 1993); *Gray v. First Winthrop Corp.*, 989 F.2d 1564 (9th Cir. 1993);

face of both the presumption of constitutionality and the weight of appellate authority, the decision of the Sixth Circuit in *Plaut v. Spendthrift Farms, Inc.*, 1993 U.S. App. LEXIS 19738 (6th Cir. August 3, 1993), stands out as an anomaly. The Court should decline to exercise its discretionary jurisdiction in *this* case, and resolve the conflict created by the Sixth Circuit in a review of *Plaut*, if that case ultimately exits the Sixth Circuit in its present form.

The opinions of the Fifth and Sixth Circuits can be readily compared and conflicts between the two easily identified. The existence of the conflict, rather than the merits of the constitutional issues over which the conflict arises is relevant to the Court's decision to exercise its jurisdiction. Nevertheless, differences in the rationales of the two circuit courts highlight the fundamental correctness of the Fifth Circuit's decision.

The Fifth Circuit supported its decision with a rationale that is consistent with contemporary due process analysis. The opinion of the Sixth Circuit rests largely on subsequently modified authority and a suspect theory of "vested rights." For many years, this Court has properly questioned the practical and theoretical utility of a "vested rights" analysis. As early as 1885, the Court observed that, while the term has some readily accepted meaning in the context of real property rights, "when we get beyond this, although vested rights may exist they are better described by some more exact term, as the phrase

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Anixter v. Home-Stake Production Co., 977 F.2d 1533 (10th Cir.), *reh'g granted in part*, 977 F.2d 1549 (1992), *cert. denied*, 113 S. Ct. 1841 (1993); *Henderson v. Scientific-Atlanta*, 971 F.2d 1567 (11th Cir. 1992), *petition for cert. filed*, June 25, 1993.

itself is not one found in the language of the Constitution." *Campbell v. Holt*, 115 U.S. 620, 628 (1887). Consistent with the Court's view expressed in *Campbell*, the Fifth Circuit has observed that the vested rights analysis begs the question of due process by "merely stat[ing] due process conclusions." *Pacific Mut. Life Ins. Co. v. First RepublicBank Corp.*, 997 F.2d 39, 47 (5th Cir. 1993).[2] Ultimately, the issues now raised before the Court are issues of due process and should be decided "according to the jurisprudence that the Court has developed to describe how due process protects individuals from retroactive legislation." *Id.*

The Petitioners here, and the current Sixth Circuit opinion in *Plaut*, ultimately rely on the authority of *McCollough v. Virginia*, 172 U.S. 102 (1898). As the Fifth Circuit has correctly concluded, the absolutist holding of *McCollough v. Virginia* has been substantially modified in *Fleming v. Rhodes*, 331 U.S. 100 (1947), and *Usery v. Turner Elkhorn Mining Co.*, 428 U.S. 1 (1976). In the proceedings below, Petitioners failed to distinguish *Fleming* and *Usery*, both of which upheld the right of Congress to deprive litigants of rights acquired by judgment and retroactively to create liability for past acts. The Fifth Circuit properly adhered to the guidance of this Court's more recent holdings, which authority superseded *McCollough*. The Sixth Circuit, however, did not consider, much less distinguish,

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[2] *TGX Corp. v. Simmons*, No. 92-3375 (5th Cir. 1992), was consolidated for hearing with *Pacific Mut. Life Ins. Co. v. First RepublicBank Corp.*, and the Fifth Circuit issued a single opinion for both cases reported under the style and caption of *Pacific Mutual*.

the intervening precedent of *Fleming* and *Usery*. Thus, it is the decision of the Sixth Circuit that is in conflict with established precedent of this Court. If any decision needs reviewing, it is the holding of the Sixth Circuit.

Petitioners also claim that Section 27A impermissibly creates liability for past acts and is thus inconsistent with this Court's holdings in *Lampf, Pleva, Lipkind, Prupis & Petigrow v. Gilbertson*, 111 S. Ct. 2773 (1991), and *William Danzer & Co. v. Gulf & Ship Island R.R. Co.*, 268 U.S. 633 (1925). Petitioners' argument lacks merit for two reasons. First, the holding in *Usery* that Congress may retroactively create liability for past acts raises a serious question as to the utility of *Danzer* in this analysis. *See Usery*, 428 U.S. at 16. Second, the holding of *Lampf* adopts the standards of Section 9(e) of the 1934 Act, 15 U.S.C. § 78i(e) as governing the limitations periods for actions under Section 10(b). As the Fifth Circuit has correctly observed, Section 9(e) speaks only of limitations on *remedies*; it is silent as to the continued existence of *liability* under the 1934 Act. *See Pacific Mutual*, 997 F.2d at 52.

Finally, the holding of the Fifth Circuit is completely consistent with the Court's recent discussion of Section 27A in *Musick, Peeler & Garrett v. Employers Ins.*, 113 S. Ct. 2085 (1993). In *Musick*, the Court was asked to decide whether an implied right of contribution was available among co-defendants in a private action under Section 10(b). As support for its conclusion that a right of contribution was available, Justice Kennedy, writing for the Court, discussed at some length the curious tension and division of labor between the Court and Congress in the

"cumulative work" of shaping the parameters and defining the content of the implied private cause of action under Section 10(b). Justice Kennedy focused particularly on the enactment of Section 27A:

> Following our resolution two Terms ago of a difficult statute of limitations issue for 10b-5 suits, Congress intervened by limiting the retroactive effect of our decision, and the caution in its intervention is instructive. In an approach parallel to the one it adopted for the insider trading statute, Congress did no more than direct the applicable "limitation period for any private civil action implied under [Section 10(b)] that was commenced on or before June 19, 1991."

Id. at 2089 (quoting Section 27A) (citations omitted).

The Court's discussion of Section 27A and its reliance on such congressional intervention as instructive within the separate spheres of judicial and congressional action, strongly suggests that the Court is content with Section 27A and that further review of the statute is not warranted.

2. Review of the Fifth Circuit's Decision is Premature.

The Sixth Circuit issued its opinion in *Plaut* on August 3, 1993. The United States of America, an intervenor in *Plaut*, has requested and received additional time within which to file a suggestion for rehearing *en banc*. On September 3, 1993, the Sixth Circuit requested briefs from the parties on the merits of the suggestion for rehearing. *See* Appendix at A23. As of this writing, the briefs have not been filed; thus, the ultimate outcome of

Plaut is far from clear. Until the Sixth Circuit has made its decision final, it is premature to maintain that a conflict exists between the Fifth and Sixth Circuits.[3]

3. Even if the Decision of the Sixth Circuit is Upheld, the Result in This Case Will Remain Unchanged.

The scope of the Sixth Circuit's opinion in *Plaut* reaches only those cases in which a final, unappealed judgment has been entered. *See* Respondents' Appendix at A61. Since *Plaut* involved an unappealed judgment of dismissal with prejudice, the issue of finality centered on whether a judgment based upon the passing of a statutory limitations period was "final" for all purposes. The Sixth Circuit concluded that such judgments are final. However, as the dissent in *Plaut* observed, there are instances, such as those created by appealed judgments, that must necessarily fall outside the reach of the Court's ruling and within the statutory reach of Congress. *See* Petitioners' Appendix at A87.

Respondents' Section 10(b) claim, unlike that of the shareholders in *Plaut*, was dismissed *without prejudice*. As this Court has observed in the context of Rule 41(a) of the

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[3] The Court has pending before it a petition for a writ of certiorari filed in the case of *Henderson v. Scientific-Atlanta, Inc.*, 967 F.2d 1567 (11th Cir.); *pet. for cert. filed* June 25, 1993. Although the issues presented in *Henderson* are not framed identically to the issues considered herein, the underlying issue of separation of powers was addressed by the Eleventh Circuit, 986 F.2d at 1571-75. Review of the petition in *Henderson* will afford the Court an opportunity to consider the constitutional dimensions of Section 27A and rule upon them in that case.

Federal Rules of Civil Procedure, "a [d]ismissal without prejudice is a dismissal that does not operate as an adjudication upon the merits . . . , and thus does not have res judicata effect." *Cooter & Gell v. Hartmarx Corp.*, 496 U.S. 384, 396 (1990). Since Respondents' claim was dismissed without prejudice, it could be refiled at the trial court level without penalty and not subject to a defense of res judicata. Accordingly, the dismissal was simply not an adjudication on the merits capable of creating in Petitioners a "right" to be free from relitigation of Respondents' claim. On the contrary, by defining the dismissal as without prejudice, the district court clearly signalled the Petitioners that their fight was not over and that refiling was not foreclosed by the dismissal.

In *Plaut*, however, the argument can be made that dismissal *with* prejudice did give rise to the defense of res judicata, which, absent Section 27A, immunized the *Plaut* defendants from relitigation of the claims against them. This crucial distinction between this case and *Plaut* raises the issue whether the holding in *Plaut*, even if upheld by this Court, would require reversal of the judgment of the Fifth Circuit in this case. Respondents submit that the distinction is dispositive. Petitioners claim that, like the defendants in *Plaut*, they cannot be deprived of the rights conferred upon them by a final judgment. However, unlike the defendants in *Plaut*, Petitioners never acquired the right they claim to have lost – the right to be free from relitigation of the Section 10(b) claim brought against them.

The conclusion drawn by the Sixth Circuit in its discussion of *United States v. Sioux Nation of Indians*, 448 U.S. 371 (1980), highlights the dispositive nature of the

relationship between principles of res judicata and dismissal without prejudice. In *Sioux Nation*, Congress retroactively waived the defense of res judicata previously interposed by the United States to bar relitigation of claims brought by Native Americans. *Id.* at 389. The Sixth Circuit cited *Sioux Nation* for the proposition that the case does not "creat[e] an exception to the longstanding rule against disturbing judgments rendered in favor of private parties," but merely "allows Congress the power only to ratchet the Government's liability to claimants in favor of private parties. . . . " *See* Petitioners' Appendix at A82. In concluding that *Sioux Nation* supported, rather than prohibited, striking down Section 27A, the Sixth Circuit specifically noted that "the very existence of this appeal suggests that defendants have not chosen to waive their defenses of res judicata with which the District Court vested them in dismissing the shareholders' case *with prejudice* as time barred." *Id.* at A83 (emphasis added).

The Sixth Circuit's reference to the dismissal below as having been with prejudice can hardly be gratuitous, particularly in the context of a discussion of res judicata. Implicit in the Sixth Circuit's conclusion is the realization, expressed by this Court in *Cooter & Gell*, that absent a dismissal with prejudice, there would be no res judicata defense available for the defendants to have waived. Thus, even under the holding of *Plaut*, reinstatement of Respondents' claim in this case would not offend due process and the doctrine of separation of powers in the manner condemned by the Sixth Circuit.

Unlike the Sixth Circuit, the Fifth Circuit had before it a non-constitutional basis to reverse the judgment of the district court in *TGX Corp. v. Simmons*. Respondents

argued below that because the dismissal without prejudice lacked res judicata effect, the judgment created in Petitioners no "right," vested or otherwise, of which Section 27A(b) could divest them. Therefore, Petitioners had failed to overcome the threshold of any alleged deprivation of due process. Although the Fifth Circuit had available to it a valid non-constitutional basis for decision in *TGX Corp. v. Simmons*, the same basis was unavailable in *Pacific Mut. Life Ins. Co. v. First RepublicBank Corp.*, which involved a final judgment of dismissal with prejudice. Since the Fifth Circuit was required to reach to full-blown due process and separation of powers issues in *Pacific Mutual*, and since, given the court's decision, the result in both cases would be the same, the Fifth Circuit chose not to rule on the non-constitutional basis of decision in *TGX*.

The Fifth Circuit's election, however, does not foreclose the issue. If the petition is granted, this Court will necessarily consider the procedural, non-constitutional grounds for upholding the decision of the Fifth Circuit before reaching the constitutional issues presented. *Jean v. Nelson*, 472 U.S. 846, 854 (1985). *See also The Monrosa v. Carbon Black Export, Inc.*, 359 U.S. 180, 183 (1959) (petition for certiorari dismissed after oral argument when it became apparent that the case could be decided as a matter of contractual law rather than by reference to a federal statute). In that event, Respondents submit that the Court will conclude, in reliance on *Cooter & Gell*, that the procedural argument raised, but not ruled on below, is sufficient to dispose of this case.

The procedural grounds for affirming the Fifth's Circuit are unique to this case. On the other hand, the constitutional issues, *if* a conflict about them survives

rehearing in the Sixth Circuit, are squarely presented in both *Plaut* and *Pacific Mutual*. Thus, either of those cases will be better suited for review.

4. The Conflict Created by the Decision of the Sixth Circuit is Limited in Duration and Scope.

The terms of Section 27A restrict the statute's application to the limited number of cases that were (1) brought under Section 10(b) of the 1934 Act, (2) pending on June 19, 1991, and (3) dismissed as time barred as a result of *Lampf*. The sub-set of cases falling within Section 27A(b) affected by the conflict between the Fifth and Sixth Circuits is further limited to Section 27A cases dismissed in a final judgment and reinstated within a sixty day safe harbor. Simple logic compels the conclusion that the entire universe of cases hanging on this "important question of federal law," Petitioners' Brief at 14, can contain no more than a handful of lawsuits.

Section 27A is a statute that has expired under its own terms. This fact ensures that the issues presented for review arising *under this statute* will not recur. The brief duration of the statute, combined with the meager number of remaining cases renders review of Section 27A by the Court inappropriate. *See United States v. Abrams*, 344 U.S. 855 (1952); *Community Services, Inc. v. United States*, 342 U.S. 392 (1952), and the discussion in R. Stern, *Denial of Certiorari Despite a Conflict*, 66 Harv. L. Rev. 465, 466-67 (1953).

CONCLUSION

The decision of the Fifth Circuit below is correct and consistent with the opinions of this Court. The opinion of the Sixth Circuit, which created the conflict upon which the petition is based, is anomalous and inconsistent with contemporary due process analysis. Therefore, if the Court determines that the conflict of opinion merits review, the Court is urged to review and reverse the holding of the Sixth Circuit. Moreover, review is premature until the judgment of the Sixth Circuit becomes final. Finally, the Court should decline to exercise its discretionary jurisdiction in this case because narrower, non-constitutional grounds exist for upholding the result reached by the Fifth Circuit in a manner consistent with the holding of the Sixth Circuit.

Respectfully submitted,

Dated: September 24, 1993

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UNITED STATES DISTRICT COURT

EASTERN DISTRICT OF LOUISIANA

TGX CORPORATION	*	CIVIL ACTION
VERSUS	*	NO. 87-5298
GAYLON D. SIMMONS AND GLORIA ANNETTE TURNER SIMMONS	*	SECTION "M"
	*	MAGISTRATE DIV. 2

CONSOLIDATED WITH

GAYLON D. SIMMONS and GLORIA ANNETTE TURNER SIMMONS	*	CIVIL ACTION
	*	NO. 90-0849
VERSUS	*	SECTION "M"
J.C. TEMPLETON, JOE H. FOY, HARRY V. CARLSON, ROBERT TED ENLOE, III, W.A. GRIFFIN, THOMAS L. KISTER, LEONARD LEON, EDWARD T. COTHAM, BRACEWELL & PATTERSON, BDO SEIDMAN, GREENWICH INSURANCE COMPANY and WILLIAM M. TEMPLETON	*	MAGISTRATE DIV. 2
	*	(Filed Aug. 5, 1991)

JUDGMENT AND ORDER

The several Motions to Dismiss for Failure to State a Claim or Alternatively for Summary Judgment of Defendants in *Simmons, et ux. v. Templeton, et al.*, came on for hearing on Wednesday, July 24, 1991. Considering the motions, memoranda, affidavits, and materials on file, and the arguments of counsel; upon finding that no issue of material fact exists, all of the federal claims asserted are time-barred, and the Defendants are entitled to judgment on those claims as a matter of law; and upon finding that there is no just reason for delay and that final judgment should be entered herein,

IT IS ORDERED, ADJUDGED AND DECREED that all of plaintiffs' claims against J. C. Templeton, Joe H. Foy, Harry V. Carlson, Robert Ted Enloe, III, W.A. Griffin, Thomas L. Kister, Leonard Leon, Edward T. Cotham, William M. Templeton, Bracewell & Patterson, BDO Seidman, Greenwich Insurance Company, Harbor Insurance Company, and Continental Insurance Company, asserted under Section 12 of the Securities Act of 1933, and the Securities Exchange Act of 1934 are hereby dismissed ~~with prejudice.~~ [P.A.B.].

New Orleans, Louisiana, this 5th day of August, 1991.

/s/ Peter A. Beer
UNITED STATES
DISTRICT JUDGE

MINUTE ENTRY
BEER, J.
SEPTEMBER 27, 1991

UNITED STATES DISTRICT COURT
EASTERN DISTRICT OF LOUISIANA

TGX CORP.	CIVIL ACTION
VERSUS	NO. 87-5298
GAYLON D. SIMMONS AND GLORIA ANNETTE TURNER SIMMONS	SECTION M

CONSOLIDATED WITH

GAYLON D. SIMMONS AND GLORIA ANNETTE TURNER SIMMONS	CIVIL ACTION NO. 90-0849 SECTION M
VERSUS	(Filed Sept. 27, 1991)
J.C. TEMPLETON, JOE H. FOY, HARRY V. CARLSON, ROBERT TED ENLOE, III, W.A. GRIFFIN, THOMAS L. KISTER, LEONARD LEON, EDWARD T. COTHAM, BRACEWELL & PATTERSON, BDO SEIDMAN, GREENWICH INSURANCE COMPANY and WILLIAM M. TEMPLETON	

The following motions in the above-styled action were heard on September 18, 1991: (1) Defendant BDO

Seidman's Motion for Summary Judgment on Plaintiffs' Negligent Misrepresentation Claim; (2) Defendant BDO Seidman's Motion to Dismiss or, alternatively, for Summary Judgment on Plaintiffs' Fifth Amended Counterclaim; (3) TGX Corporation's Motion for Review of Magistrate's Ruling on Plaintiffs-in-Counterclaim's Motion for Leave to File Fifth Amended Counterclaim; (4) Defendant BDO Seidman's Motion for Review of Magistrate's Order granting plaintiffs leave to file a fifth amended counterclaim; (5) Defendants' (individual TGX directors and Bracewell & Patterson) Objection to Magistrate's Ruling or, alternatively, Motion to Dismiss, and (6) Defendant Greenwich Insurance Company's Objection to Magistrate's Ruling or, alternatively, Motion to Dismiss.

The court holds that motion (1) is denied. Motions (2)-(6) are granted insofar as the federal claims contained in plaintiffs' fifth amended counterclaim are dismissed as time-barred, and the state claims are dismissed based on this court's discretionary refusal to exercise pendent jurisdiction. The state claims are dismissed without prejudice, leaving plaintiffs to pursue those claims in state court.

BACKGROUND

In November 1986, the Simmons sold their full interest in LEDCO, Inc., to TGX Corp. (TGX) for approximately $21,000,000. Plaintiffs received $11,000,000 in cash; 300,000 shares of preferred TGX stock, valued at approximately $3,000,000; real property; forgiveness of a $1,000,000 debt owed by plaintiffs to LEDCO; and,

deferred consideration of $5,000,000 plus interest, to be paid in annual installments.

Plaintiffs contend that, because the TGX stock has proven worthless and none of the deferred payments has been made, they have received only $13,000,000 instead of the expected $21,000,000. Plaintiffs claim their $8,000,000 in damages was caused by their reliance on TGX's financial statements in agreeing to the LEDCO sale. Plaintiffs contend the statements did not disclose the existence of a lawsuit pending against TGX, which caused the devaluation of TGX stock and rendered TGX unable to honor its deferred payment obligations. TGX was eventually forced into bankruptcy.

TGX sued the Simmons in 1987, and the Simmons counterclaimed alleging violations of the Securities Act of 1933 ("1933 Act"), the Securities Exchange Act of 1934 ("1934 Act") and the Louisiana Blue Sky law. The suit was automatically stayed when TGX filed for bankruptcy under Chapter 11 in February 1990. On March 3, 1990, the Simmons filed suit against TGX's individual directors, and its law (Bracewell & Patterson) and accounting (BDO Seidman) firms, alleging negligent misrepresentation and violations of Section 10(b) of the 1934 Act, Rule 10b-5 promulgated thereunder, and the Louisiana Blue Sky law. The 1987 and 1990 suits have been consolidated, and the matter is set for trial in March 1992.

I. DEFENDANT BDO SEIDMAN'S MOTION FOR SUMMARY JUDGMENT ON PLAINTIFFS' NEGLIGENT MISREPRESENTATION CLAIM

Defendant, as TGX's accounting firm, prepared the financial statements on which plaintiffs allegedly relied in agreeing to the LEDCO sale. Plaintiffs claim defendant is guilty of negligent misrepresentation because TGX's financial statements did not accurately reflect TGX's troubled financial status prior to the LEDCO deal. Defendant seeks summary judgment, claiming it had no duty to plaintiffs under Louisiana's negligent misrepresentation law and therefore cannot be held liable for their losses.

Defendant's motion for summary judgment is hereby denied. As accountant for a publicly-traded corporation, defendant had a duty to all potential investors, including plaintiffs, to provide accurate financial information on which they could base investment decisions. Material questions remain as to whether defendant discharged its duty. Such questions preclude the entry of summary judgment on defendant's behalf.

The law of summary judgment is well-settled. Summary judgment is appropriate if "there is no genuine issue as to any material fact and . . . the moving party is entitled to a judgment as a matter of law." Fed.R.Civ.P. 56(c). When the moving party has carried its burden under Rule 56(c), the burden shifts and the non-moving party can defeat a summary judgment motion only by "set[ting] forth specific facts showing there is a genuine issue for trial." Fed.R.Civ.P. 56(e). Because Louisiana law

applies in this case, it determines what facts are "material" to plaintiffs' action. *Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 248 (1986).

The parties agree that Louisiana has adopted Restatement 2d of Torts section 552, entitled "Information Negligently Supplied for the Guidance of Others," for evaluating negligent misrepresentation claims. The parties cite different subsections of section 552, however, to support their respective contentions. Defendant relies on subsections (2)(a) and (2)(b), which state that the liability of one who negligently misinforms another is limited to the loss suffered

> (a) by the person or one of a limited group of persons for whose benefit and guidance he intends to supply the information or knows that the recipient intends to supply it; and
>
> (b) through reliance upon it a transaction that he intends the information to influence or knows that the recipient so intends or in a substantially similar transaction.

Restatement (Second) of Torts § 552(2) (1977). Plaintiffs, by contrast, rely on subsection (3), which states that

> The liability of one who is under a public duty to give the information extends to loss suffered by any of the class of persons for whose benefit the duty is created, and any of the transactions in which it is intended to protect them.

Id. at § 552(3). Whether subsection (2) or subsection (3) applies thus hinges on whether defendant was under a public duty to provide accurate information in TGX's financial reports.

The court finds that defendant had a public duty to provide accurate information concerning TGX's financial health. This duty has been created by both statute and common law. A legal duty may be created by statute. *French Mkt. Plaza Corp. v. Sequoia Ins. Co.*, 480 F.Supp. 821, 824-25 (E.D.La. 1979). The federal securities laws obligate public accountants to provide fair and accurate information concerning a public corporation's financial status. *See, e.g.*, 15 U.S.C.A. §§ 78m(a), 78r(a) (1981). Thus, defendant had a statutory duty to the investing public to provide accurate financial information regarding TGX.

The Supreme Court has similarly imposed a duty on accountants to provide the public with accurate information. In *United States v. Arthur Young & Co.*, 465 U.S. 805 (1984), the Internal Revenue Service sought to investigate corporate tax returns which had been reviewed and verified by respondent public accounting firm. Respondent corporation ordered the accounting firm to withhold requested tax accrual papers, claiming they were privileged. The Court held that the summons compelling production of said documents was enforceable, rejecting a claim that the tax accrual papers were analogous to the attorney work product found unreachable in *Hickman v. Taylor*, 329 U.S. 495 (1947). *Id.* at 817. The Court stated that the *Hickman* doctrine was based on the attorney's role as a private, confidential advisor, while

> [a]n independent certified public accountant performs a different role. By certifying the public reports that collectively depict a corporation's financial status, the independent auditor assumes a *public* responsibility transcending any employment relationship with the client.

Id. at 817 (emphasis in original). Similar to its statutory duty, defendant thus also had a common law duty to provide accurate information to the investing public.[1]

Because defendant was under a public duty, Restatement 2d section 552(3) applies, and the question becomes whether plaintiffs were members of the class of persons for whose benefit the duty has been created. As potential investors in a publicly-traded corporation, plaintiffs appear to be the exact persons for whom the public duty was created. The federal disclosure requirements were enacted to benefit investors by promoting fairness in

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[1] Defendant cites *First National Bank of Commerce v. Monco*, 911 F.2d 1053 (5th Cir. 1990), in claiming it had no duty to plaintiffs, and that summary judgment on plaintiffs' claim is therefore proper. The *Monco* court, applying Louisiana law, affirmed a summary judgment in favor of an accounting firm on whose financial report a bank had relied in making a defaulted loan to the firm's client. The court stated that summary judgment was proper because "Louisiana law does not protect every reasonably foreseeable consumer of inaccurate auditing information." *Id.* at 1055.

Monco can be distinguished from the current proceedings. Unlike BDO Seidman, the accounting firm in *Monco* believed its audit report would be distributed only to a small, ascertainable group of third parties. There is no indication the client in *Monco* was a publicly-traded company subject to federal disclosure requirements. The accounting firm in *Monco* reasonably believed its report would go only to select recipients, and it was only to those recipients that the firm owed a duty of accuracy. Accordingly, the firm was not liable when the report was relied upon by a bank not in the foreseeable class of recipients. By contrast, defendant BDO Seidman was aware that potential investors in TGX would rely on its report. As such, its duty extended beyond the limited duty imposed on the accounting firm in *Monco*.

corporation-investor transactions. *See Fisher v. Kletz*, 266 F.Supp. 180, 184 (S.D.N.Y. 1967) (section 13(a) of the 1934 Act, 18 U.S.C.A. § 78m(a) (1981), requires a public accountant to "report fairly on the facts as he finds them whether favorable or unfavorable to his client. His duty is to safeguard the public interest, not that of his client."). Investors such as plaintiffs thus are within the class of persons for whose benefit defendant's duty to provide accurate information was created.

Defendant thus had a public duty to provide plaintiffs with accurate information concerning TGX's financial status. Material questions bearing on the discharge of that duty remain contested, and summary judgment is therefore improper. Plaintiffs claim that a brief statement in defendant's 1986 SEC filings[2] did not satisfy federal disclosure requirements. Whether the filings represented a fair and accurate disclosure of TGX's status so as to discharge defendant's public duty constitutes a material question of fact sufficient to deny defendant's motion for summary judgment.[3]

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[2] In 1986 SEC filings, the only reference to pending litigation in was that, "From time to time, in the normal course of business, the Company is a party to various matters of litigation. Management is of the opinion that the eventual outcome of these matters will not have a material adverse effect on the Company."

[3] An additional reason for denying defendant's motion is that plaintiffs have not completed their discovery. Federal Rule of Civil Procedure 56(f) states that a court may refuse an application for summary judgment in order to "permit affidavits to be obtained or depositions to be taken or discovery to be had. . . ." Fed. R. Civ. P. 56(f). The Fifth Circuit has recently held that summary judgment motions should more readily be denied

Defendant's motion for summary judgment is hereby denied.

II. MOTIONS OBJECTING TO MAGISTRATE'S RULING OR, ALTERNATIVELY, SEEKING DISMISSAL OF PLAINTIFFS' FIFTH AMENDED COUNTERCLAIM

On August 22, 1991, Magistrate Wynne granted plaintiffs leave to file a fifth amended counterclaim in the 1987 suit. Leave was granted pursuant to Federal Rule of Civil Procedure 15(a), which states that second and subsequent leaves to amend "shall be freely given when justice so requires." Fed.R.Civ.P. 15(a). Magistrate Wynne granted plaintiffs' motion on a procedural basis only, and expressly left it to this court to determine whether substantive law bars plaintiffs' claims. The remaining motions heard on September 18 all challenge Magistrate Wynne's ruling or, alternatively, seek dismissal of the claims contained in plaintiffs' fifth amended counterclaim.[4]

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where the nonmovant has not completed its discovery. *See International Shortstop, Inc. v. Rally's, Inc.*, No. Civ. 90-8563, slip op. at 5737-39 (5th Cir. Aug. 29, 1991).

[4] Plaintiffs' fifth amended counterclaim contained the following allegations:

(1) J.C. Templeton, President and Chairman of the Board of TGX, was charged with (a) violating section 10(b) of the 1934 Act, Rule 10b-5 promulgated thereunder, and the Louisiana Blue Sky law; (b) conspiracy to defraud; and, (c) controlling person liability for TGX Corp.'s alleged violations of the 1933 and 1934 Acts;

(2) TGX Corp. was charged with (a) violating section 12(2)

A. Federal Securities Claims

Magistrate Wynne did not address defendants' contentions that the federal claims in plaintiffs' fifth amended counterclaim are barred by res judicata or, alternatively, that they are time-barred under the Supreme

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of the 1933 Act; (b) violating section 10(b) of the 1934 Act, Rule 10b-5 promulgated thereunder, and the Louisiana Blue Sky law; (c) breach of contract; (d) fraud; and, (e) misrepresentation;

(3) BDO Seidman, TGX's accounting firm, was charged with (a) violating section 10b of the 1934 Act, Rule 10b-5 promulgated thereunder, and the Louisiana Blue Sky law; and, (b) negligent misrepresentation;

(4) Bracewell & Patterson, TGX's outside counsel, was charged with (a) violating section 10b of the 1934 Act, Rule 10b-5 promulgated thereunder, and the Louisiana Blue Sky law; (b) conspiracy to defraud; and, (c) vicarious liability for the acts of its agent, Joe Foy;

(5) Joe Foy, a partner at Bracewell & Patterson and a director of TGX, was charged with (a) violating section 10b of the 1934 Act, Rule 10b-5 promulgated thereunder, and the Louisiana Blue Sky law; (b) conspiracy to defraud; and, (c) controlling person liability for TGX Corp.'s alleged violations of the 1933 and 1934 Acts;

(6) Individual director defendants Carlson, Enloe, Griffin, Kister, Leon, W. Templeton, and Cotham were charged with (a) conspiracy to defraud; (b) violating section 10b of the 1934 Act, Rule 10b-5 promulgated thereunder, and the Louisiana Blue Sky law; and, (c) controlling person liability for TGX Corp.'s alleged violations of the 1933 and 1934 Acts;

(7) Individual director defendants J.C. Templeton, Foy, Carlson, Enloe, Griffin, Kister, Leon, W. Templeton and Cotham were charged with (a) tortious interference with contract; (b) breach of fiduciary duty; (c) negligent mismanagement; (d) fraud; and, (e) negligent misrepresentation; and

(8) Greenwich Insurance Co., liability insurer of director defendants, was charged with solidary liability and wrong refusal to pay or settle a claim.

Court's recent decision in *Lampf v. Gilbertson*, 1991 U.S. LEXIS 3629 (June 20, 1991). This court now holds that plaintiffs' federal claims are not barred by res judicata, but are time-barred because the claims cannot relate back to the date of plaintiffs' original filing in the 1987 suit. The federal claims contained in plaintiffs' fifth amended counterclaim are therefore dismissed as untimely.

Res Judicata: The federal claims in plaintiffs' fifth amended counterclaim are not barred by res judicata. The federal claims were dismissed from the 1990 suit without prejudice. Such a dismissal is not on the merits, and therefore does not trigger res judicata.

In August 1991, plaintiffs' federal securities claims in the 1990 lawsuit were dismissed without prejudice by this court. *See* Judgment and Order of August 5, 1991. The Supreme Court has recently stated that a " '[d]ismissal without prejudice' is a dismissal that does not 'operat[e] as an adjudication upon the merits,' and thus does not have a res judicata effect." *Cooter & Gell v. Hartmarx Corp.*, 110 S.Ct. 2447, 2456 (1990) (quoting Fed.R.Civ.P. 41(a)(1)). The Fifth Circuit has similarly stated that res judicata attaches only to dismissals on the merits. *See Steven D. Thompson Trucking, Inc. v. Dorsey Trailers, Inc.*, 870 F.2d 1044, 1045-46 (5th Cir. 1989).

Defendants cite *Thompson Trucking* and *Nilsen v. City of Moss Point*, 701 F.2d 556 (5th Cir. 1983) (en banc), to support their contention that the federal securities claims in plaintiffs' fifth amended counterclaim are barred by res judicata. Both precedents are distinguishable from the current proceedings.

Thompson Trucking held a limitations-based dismissal to be on the merits and therefore capable of triggering res judicata. *Thompson Trucking*, 870 F.2d at 1046. Defendants argue that, because the dismissal of plaintiffs' federal securities claims from the 1990 suit was limitations-based, the dismissal was on the merits and res judicata applies. Defendants ignore, however, the crucial distinction between *Thompson Trucking* and plaintiffs' claims. The claim in *Thompson Trucking* was dismissed with prejudice, while plaintiffs' claims in the 1990 suit were dismissed without prejudice. Consistent with *Cooter & Gell*, *Thompson Trucking* merely held that a dismissal with prejudice constitutes a final judgment on the merits for res judicata purposes. *Thompson Trucking* does not address the res judicata effects of a dismissal without prejudice.

Defendants' reliance on *Nilsen* is similarly misplaced. Plaintiff in *Nilsen* filed four consecutive suits alleging Title VII violations by her employer. In *Nilsen I*, plaintiff's claim was dismissed without prejudice, and thus did not bar the filing of *Nilsen II* and *III*. Plaintiff then filed *Nilsen IV*, which the Fifth Circuit dismissed on res judicata grounds based on the dismissals of *Nilsen II* and *III*. Both *Nilsen I* and the Simmons' federal claims in the 1990 suit were thus dismissed without prejudice, and just as the dismissal of *Nilsen I* did not bar the filing of *Nilsen II-III*, the dismissal of the Simmons' federal claims from the 1990 suit does not bar the filing of their fifth amended counterclaim.

The federal securities claims in plaintiffs' fifth amended counterclaim are not barred by res judicata.

Time-Bar and Relation Back: While the federal securities claims in plaintiffs' fifth amended counterclaim are not barred by res judicata, they are time-barred because the claims cannot relate back to plaintiffs' original filing in the 1987 suit.

In *Lampf v. Gilbertson*, 1991 U.S. LEXIS 3629 (June 20, 1991), the Supreme Court held that litigation under section 10(b) of the Securities Exchange Act of 1934, and Rule 10b-5 promulgated thereunder, had to be commenced within one year of the discovery of an alleged violation and within three years of such alleged violation. The three-year period was defined as a "period of repose," granting potential defendants a substantive right to be free from liability arising out of a challenged transaction after the period had run. The parties have already agreed that *Lampf* applies retroactively to bar plaintiffs' federal securities claims in the 1990 suit. The parties disagree, however, on whether the claims are similarly barred in the 1987 suit.

The relevant transaction between plaintiffs and TGX closed on November 14, 1986. Plaintiffs state they first discovered the alleged violations of section 10(b) and Rule 10b-5 in March 1989. They filed an amended counterclaim alleging fraud on April 25, 1989, within the time limits set by *Lampf*. Whether the federal claims in plaintiffs' fifth amended counterclaim are now time-barred hinges on whether said claims can relate back to the date of plaintiffs' original filing.

Defendants claim that, since the three-year period set in *Lampf* is a period of repose, it cannot be circumvented by relation back under Federal Rule of Civil Procedure

15. They cite *Resolution Trust Corp. v. Olsen*, 1991 U.S. Dist. LEXIS 10337 (D. Ariz. May 31, 1991), in which the court stated that "relation-back under Rule 15 does not apply when the statute at issue defines substantive rights rather than merely limiting procedural remedies." Plaintiffs claim that, regardless of whether the limitations period is a statute of limitations (procedural) or a period of repose (substantive), relation back is proper as long as defendants had notice during the limitations period that they may be subject to liability, and the relation back would not cause defendants undue prejudice.

Plaintiffs' federal claims should not be barred merely because the three-year limitation stated in *Lampf* is a period of repose. Rule 15(c) speaks only of the "period provided by law for commencing the action," Fed.R.Civ.P. 15(c), and thus does not distinguish between periods of repose and statutes of limitations. Moreover, courts have permitted relation back under section 12(2) of the Securities Act of 1933, despite a period of repose similar to that set in *Lampf* for section 10(b) and Rule 10b-5. *See, e.g., Kilmartin v. H.C. Wainwright & Co.*, 637 F.Supp. 938, 943 (D. Mass. 1986) (amended complaint relates back, despite expiration of section 12(2)'s period of repose, because notice and prejudice requirements of Rule 15(c) are satisfied); *Brener v. Becker Paribas, Inc.*, 628 F.Supp. 442, 453 (S.D.N.Y. 1985) (amendment adding section 12(2) claim after expiration of period of repose relates back because defendant cannot prove undue prejudice or delay of trial). *Kilmartin* and *Brener* hold that a period of repose is not a per se bar to relation back. There is no basis for holding that the period of repose set in *Lampf* should have a more preclusive effect than the period set for

section 12(2). Whether plaintiffs' claims are time-barred, therefore, hinges solely on whether the requirements of Rule 15(c) have been satisfied.

This court now holds that plaintiffs' claims are time-barred because plaintiffs cannot satisfy the requirements for relation back. Based on Rule 15(c), the Supreme Court has established four factors which plaintiffs must prove for their fifth amended counterclaim to relate back to their original filing:

> (1) the basic claim must have arisen out of the conduct set forth in the original pleading; (2) the party to be brought in must have received such notice that it will not be prejudiced in maintaining its defense; (3) that party must or should have known that, but for a mistake concerning identity, the action would have been brought against it; and (4) the second and third requirements must have been fulfilled within the prescribed limitations period.

Schiavone v. Fortune, 477 U.S. 21, 29 (1986). All four factors must be satisfied before relation back will apply. *Id.*; *Bell v. Veterans Admin. Hosp.*, 826 F.2d 357, 360 (5th Cir. 1987).

Plaintiffs arguably can satisfy the first and second *Schiavone* requirements, but they cannot satisfy the third and fourth requirements. Plaintiffs' federal securities claims therefore cannot relate back to plaintiffs' original filing in the 1987 suit, and the claims are untimely under *Lampf*.

Rule 15(c) was intended to ameliorate the harsh consequences that would otherwise result where a confusing bureaucratic structure caused a plaintiff to name the wrong government agency or the wrong member of a

corporate conglomerate as defendant. *See* Fed.R.Civ.P. 15(c) advisory committee's note to 1966 Amendment. Rule 15(c) was not designed to afford plaintiffs a second chance where they omit defendants from earlier claims based not on mistaken identity, but rather on a tactical decision believed at the time to be in plaintiffs' best interests. The Simmons knew the identities of all defendants at the filing of their 1989 counterclaim, as such information was contained in the financial documents which plaintiffs reviewed prior to entering the LEDCO sale. Plaintiffs chose to name only the corporate defendant, however, because they feared Rule 11 sanctions if their securities claims later proved to be unfounded. " 'Relation back' will not apply where, as here, the plaintiff is aware of a potential defendant, but is simply unsure about that party's potential liability." *Milandra Milling Corp. v. Ogilvie Mills, Inc.*, 746 F.Supp. 40, 42-43 (D. Kan. 1990) (footnote omitted).

The federal securities claims in plaintiffs' fifth amended counterclaim cannot relate back to the filing of plaintiffs' 1989 counterclaim. These claims are therefore time-barred by the three-year periods of repose for section 12(2) of the 1933 Act, section 10(b) of the 1934 Act, and Rule 10b-5 promulgated thereunder. The federal securities claims in plaintiffs' fifth amended counterclaim are hereby dismissed.

B. State Law Claims

Plaintiffs' fifth amended counterclaim also contains two sets of state law claims. One set, pled in Count Six of plaintiffs' original complaint, alleges breach of fiduciary

duty and tortious interference with contract. The second set contains fraud claims and a claim under Louisiana's Blue Sky law. La. Rev. Stat. Ann. § 51:701-724 (West 1987 & Supp. 1991). The court now hereby declines to exercise its pendent jurisdiction[5] and dismisses both sets of state law claims without prejudice, leaving plaintiffs to pursue those claims in state court.

Plaintiffs' state law claims would be subject to this court's jurisdiction if federal question jurisdiction were present and the state claims were subject to pendent jurisdiction. To establish pendent jurisdiction, plaintiffs must prove that their "state and federal claims . . . derive from a common nucleus of operative fact." *United Mine Workers v. Gibbs*, 383 U.S. 715, 725 (1966).

Count Six claims: In their original counterclaim, plaintiffs alleged, inter alia, breach of fiduciary duty and tortious interference with contract. Because the events supporting these claims occurred after the November 1986 transaction on which plaintiffs' federal claims were based, the state claims were never subject to this court's pendent jurisdiction.[6] These state claims are hereby

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[5] The court notes that there is no diversity jurisdiction over plaintiffs' state claims because there is not complete diversity among the parties. Plaintiffs and defendant William Templeton are domiciled in Louisiana.

[6] *See Texwood, Ltd. v. Gerber*, 621 F.Supp. 585 (S.D.N.Y. 1985). In *Texwood*, plaintiff joined state claims with a federal 10b-5 claim. The court dismissed a state claim alleging post-sale breach of fiduciary duty, because the facts supporting the state claim arose after the sale which formed the basis of the federal claim. *Id.* at 590. Similar to the dismissed state claim in *Texwood*, plaintiffs' Count Six claims arise from post-transaction facts

dismissed without prejudice, leaving plaintiffs to pursue these claims in state court.

Fraud and Louisiana Blue Sky claims: Plaintiffs' federal claims have herein been dismissed. "When a . . . narrowing of the issues excludes all federal claims, whether a pendent state claim should be remanded to state court is a question of judicial discretion. . . . " *In re Carter*, 618 F.2d 1093, 1101 (5th Cir. 1980) (citations omitted), *cert. denied sub nom. Sheet Metal Workers' Int'l Ass'n v. Carter*, 450 U.S. 949 (1981). The court hereby exercises its discretion and dismisses these state claims without prejudice, leaving plaintiffs to pursue these claims in state court.

The Supreme Court has indicated that dismissal of plaintiffs' fraud and Blue Sky claims is proper. In *United Mine Workers v. Gibbs*, the Court stated that,

> if the federal claims are dismissed before trial . . . the state claims should be dismissed as well. (footnote omitted) Similarly, if it appears that the state issues substantially predominate . . . the state claims may be dismissed without prejudice and left for resolution to state tribunals.

Gibbs, 383 U.S. at 726-27. Both examples in *Gibbs* support the dismissal of plaintiffs' fraud and Blue Sky claims. Plaintiffs' federal claims are being dismissed pretrial; and, once plaintiffs' federal claims are dismissed, state issues not only will "predominate," but will be the sole

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distinct from the pre-transaction facts supporting their federal claims. *Texwood* demonstrates that the Count Six claims are not subject to the court's pendent jurisdiction, and should be dismissed.

issues in the case. *Gibbs* states that such circumstances warrant the dismissal of plaintiffs' otherwise-pendent state claims. Plaintiffs' fraud and Blue Sky claims are therefore dismissed without prejudice, leaving plaintiffs to pursue these claims in state court.

In summary, plaintiffs' federal securities claims in the fifth amended counterclaim are not barred by either res judicata or the existence of a period of repose. The federal claims are time-barred, however, because the claims cannot relate back to plaintiffs' original filing. The federal claims are therefore dismissed.

All state claims in plaintiffs' fifth amended counterclaim are also dismissed. The claims contained in Count Six of plaintiffs' original complaint do not arise from the same nucleus of operative facts as the federal claims, and thus are not subject to the court's pendent jurisdiction. The fraud and Louisiana Blue Sky claims are dismissed in the court's discretion. The dismissal of all state law claims is without prejudice, leaving plaintiffs to pursue these claims in state court.

CONCLUSION

Defendant BDO Seidman's motion for summary judgment on plaintiffs' negligent misrepresentation claim is DENIED. All remaining motions are GRANTED insofar as they seek dismissal of the federal and state claims contained in plaintiffs' fifth amended counterclaim to the 1987 suit.

Defendants are requested jointly to submit a judgment consistent with this minute entry.

/s/ Peter Beer
Peter Beer
United States
District Judge

UNITED STATES COURT OF APPEALS
SIXTH CIRCUIT
U.S. POST OFFICE & COURTHOUSE BUILDING
CINCINNATI, OHIO 48202-3985

LEONARD GREEN
CLERK

TELEPHONE
ILLEGIBLE
ILLEGIBLE

September 3, 1993

Mr. Glenn C. Van Bever
Mr. L. Clifford Craig

Re: Case No. 92-5591
Plaut, et al. v. Spendthrift Farm, Inc., et al.

Dear Counsel:

This is to advise that the court directs you to file a response to the appellants' and intervenor's petition for rehearing en banc in the above case. Your response should not exceed ten pages. You should file twenty-five (25) copies of the response and it is to be received in the clerk's office no later than the close of business on Friday, September 17, 1993. Please note that no extensions will be granted.

Very truly yours,

/s/ Leonard Green/pc
Leonard Green
Clerk

pc

cc: Mr. J. Montjoy Trimble
Mr. Mark B. Stern
Mr. Douglas N. Letter